

REVISED ANALYSIS

Franchise Tax Board

Author: Shelley Analyst: Marion Mann DeJong Bill Number: AB 483
Related Bills: See Legislative History Telephone: 845-6979 Amended Date: 08/27/2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Insurance Dividend Deduction/Allow 100% Deduction/Ceridian V. FTB

- ☒ REVENUE ESTIMATE CHANGED.
☐ FURTHER CONCERNS IDENTIFIED.
REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED
☒ August 27, 2001, STILL APPLIES.
☐ OTHER - See comments below.

SUMMARY OF BILL

This bill would allow certain corporations a 100% deduction for dividends received from an insurance company subsidiary.

SUMMARY OF REVISION

The "Economic Impact" of the department's analysis of AB 483 as amended August 27, 2001, has been revised to reflect information obtained in a recent survey of audit cases. In addition, the *Ceridian* case discussion under "Federal/State Law" from that analysis has been revised to reflect a recent Legislative Counsel opinion. The remainder of the department's prior analysis still applies. The "Position" remains pending.

ANALYSIS

FEDERAL/STATE LAW

Ceridian Case

The taxpayer in *Ceridian Corp. v. Franchise Tax Board* (2000) 85 Cal. App. 4th 875 challenged the limitation on the deduction for dividends received from insurance company subsidiaries set forth in B&CTL Section 24410. Ceridian was denied the deduction because the corporation was domiciled outside of California.

The California Court of Appeal ruled that the deduction for dividends received by holding companies from insurance company subsidiaries under B&CTL Section 24410 is unconstitutional for two reasons. First, it violated the commerce clause by allowing a deduction for insurance company dividends only to corporations domiciled in California. Second, it violated the commerce clause because the amount of the deduction is limited according to a formula based on the subsidiary's gross receipts, payroll, and property within California.

Board Position:

☐ S ☐ NA ☐ NP
☐ SA ☐ O ☐ NAR
☐ N ☐ OUA ☒ PENDING

Legislative Director

Date

Brian Putler

02/19/02

There were differing views on whether or how the deduction for dividends received from insurance company subsidiaries should be applied after *Ceridian*. Generally, if provisions of a statute are found to be unconstitutional, the remaining provisions of the statute can be preserved if the unconstitutional portion can be stricken without affecting the other parts. If the remaining provisions cannot be saved, the statute is void as unenforceable. (*Kopp v. Fair Political Practices Comm.* (1995) 11 Cal. 4th 607, 641.)

The Legislative Counsel of California issued an opinion on December 7, 2001, that Section 24410 is inoperative and unenforceable as a result of *Ceridian*. The Legislative Counsel concluded that the provisions of Section 24410 could not be severed to eliminate the unconstitutional provisions and leave a 100% deduction for dividends received from an insurance company subsidiary. Thus, no deduction is allowed.

ECONOMIC IMPACT

Revenue Estimate

The revenue implications of this bill depend on whether the current baseline after the *Ceridian* decision is a 100% deduction for dividends received from an insurance company subsidiary for all corporations or no deduction is allowed. Under the latter position, revised revenue losses are projected at \$165 million (tax and interest) for open years (1997-2000) and at \$33 million annually for ongoing years based on data discussed below. However, if the current baseline reflects the former position of a 100% deduction, this bill would not impact revenue.

Revenue Discussion

The revenue effects would be determined by a number of factors: (1) the amount of dividends received by a recipient, (2) the amount of dividends identified as business income, (3) the average apportionment factor of each recipient, and (4) each recipient's tax liability in California.

Previous estimates have been revised to reflect a recently completed survey of audit cases in current inventory. The survey was limited to the 1997 through 2000 tax years. Returns were not selected in a statistical manner; therefore, it is not possible to statistically expand the results to the potential universe of tax returns impacted by the *Ceridian* decision. Where data were sparse or missing for the 1999 and 2000 tax years, results were extrapolated from the 1997 and 1998 tax years. For tax returns identified, an auditor calculated the tax effect for allowing a 100% deduction for each year. For the open year estimate above, interest was calculated through June 30, 2002, and added to the tax amount for each year. Tax and interest for open years were summed.

LEGISLATIVE STAFF CONTACT

Marion Mann DeJong
Franchise Tax Board
845-6979

Brian Putler
Franchise Tax Board
845-6333